UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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| In Re: | : | Case No. 05-60006 |
| REFCO, INC., | : | |
| Debtor. | : | |
| AXIS REINSURANCE COMPANY, | : | 07-0712-RDD |
| Plaintiff, | : | |
| v. | : | One Bowling Green<br>New York, New York |
| BENNETT, et al., | : | |
| Defendants. | : | October 12, 2007 |

TRANSCRIPT OF HEARING ON SUMMARY JUDGMENT MOTION
BEFORE THE HONORABLE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

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(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

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| For Dennis Klejna, Gerald Sherer, William Sexton, and Philip Silverman: | HELEN B. KIM, ESQ.<br>Baker & Hostetler LLP<br>12100 Wilshire Boulevard, 15th Floor<br>Los Angeles, California 90025-7120 |
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| For Robert Trosten: | BARBARA MOSES, ESQ.<br>Orrick, Herrington & Sutcliffe, LLP<br>666 Fifth Avenue<br>New York, New York 10103 |
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Proceedings recorded by electronic sound recording, transcript produced by transcription service

(Proceedings began at 10:11 a.m.)

THE COURT: Okay. We're here on the Refco / Axis Reinsurance Company summary judgment motion.

MS. KIM: Good morning, Your Honor. Helen Kim with Baker and Hostetler. I represent defendant -- counterclaim plaintiff, Dennis Klejna, and I'm presenting the oral argument on behalf of Mr. Klejna, as well as counterclaim plaintiffs William Sexton, Gerald Sherer, and Philip Silverman.

Your Honor, we seek summary judgment on the grounds that the express terms of the Axis policy requires Axis to pay defense costs as incurred. There's no dispute between the parties that where the terms of a policy provides for advancement of defense costs insurer must advance until there's been an adjudication of no coverage. And for that purpose, Your Honor, we have cited the WorldCom and Kozlowski [Ph.] cases, as well as numerous other cases around the country.

So we start in this case with the language of the U.S. Specialty policy, the primary policy as to which the Axis policy follows form. The insuring agreement (a) of the U.S. Specialty policy requires that the insurer pay losses, which includes defense costs as incurred for a claim for wrongful acts, and condition (b)(2) of the primary policy provides that the insurer will pay the covered defense costs on an incurred basis if it is finally determined that any defense costs paid by the insurer are not covered under the policy.

The insureds agree to repay such noncovered defense costs to the insurer. So the Axis policy, which follows the form of the U.S. policy, has a two-step process, payment as incurred of defense costs, and repayment of those defense -- of noncovered defense costs if there's a final determination of no coverage.

So the crux of the issue before this court is the legal interpretation of Axis's obligation to pay defense costs. Now, Axis takes the position that its obligation to advance defense costs are triggered only when coverage is undisputed. According to Axis, and I quote from its brief, "The Axis policy expressly allows Axis to make the initial determination of whether or not something is covered."

Now, we've searched the Axis policy and the underlying primary policy high and low and we can't find any provision in the Axis policy that gives Axis that right and Axis cites none. I note it seems that U.S. Specialty and Lexington, the first Axis carriers, also couldn't find any provision either because it's undisputed that based on the very same language of that primary policy both U.S. Specialty and Lexington advanced defense costs until the polices were exhausted.

We note that condition (d)(2) would be rendered illusory if Axis could avoid its obligation to advance simply by disclaiming coverage. So when we look at the term "payment

of covered defense costs," we believe that the term "covered" refers to a Claim -- that's capital C claim and that's a defined term -- for a wrongful act, in this case a securities claim.

And to determine whether an action is covered we must look to the face of the pleading, the complaint, to see if there are any facts or grounds alleged that would bring the action within the liability coverage purchased. That's precisely the approach that was taken by the Appellate Division first department in Kozlowski and other cases as well. So, Your Honor, we submit that if this were a car accident, this would not be a claim for a wrongful act. We would acknowledge that based on the pleadings on the face of the complaint that such a claim would not be covered for payment of defense costs.

Now, in this case, Axis concedes that the underlying actions constitute a claim which falls within the insuring agreement. You note that they make that express concession on page 12 of their brief, but it takes the position that it's entitled to apply the knowledge exclusion and that this court must defer to Axis's initial determination that the knowledge exclusion has been triggered. For that purpose, Axis asserts that the knowledge exclusion has been triggered by Mr. Bennett's alleged knowledge.

We submit, Your Honor, that as a matter of law Axis can only invoke a policy exclusion to avoid coverage if it can

show that the allegations of the complaint cast the pleadings solely and entirely within the policy exclusions. Both the Tyco case and the Carlin Equities case, which Axis brought to the Court's attention by letter on Wednesday make that point very clear and I want to thank Axis for bringing the Carlin Equities case to the Court's attention and, in fact, if I had found the case myself I would have relied upon it.

Both Koslowski and Tyco on all three cases, Koslowski, Tyco, and Carlin Equities make clear that unless it's clear from the face of the pleadings in the underlying action that the claims fall entirely within the scope of an exclusion, the insurer's obligation to advance defense costs remains. Here Axis cannot meet that burden and it has not.

Axis can't establish from the face of the pleadings in our underlying actions that the claims fall within the knowledge exclusion. In fact, as the Court is aware the issue of Bennett's knowledge, what he knew, and when he knew it is hotly disputed. It's at the heart of the underlying securities actions, as well as the criminal action against Mr. Bennett and others. That issue will have to be resolved in those underlying actions and can't be resolved on the face of the pleadings.

So we're left with a situation where an exclusion is disputed and, in fact, the counterclaim plaintiffs have asserted that exclusion doesn't even exist at all because it

was improperly added by Axis after the commencement of the policy period and in terms of the police binder. We're not aware of any case, and Axis cites none, where advancement was denied based on an exclusion that was disputed or that required proof of a disputed fact.

In fact, therefore, Your Honor, Axis has the obligation and retains the obligation to pay defense costs subject to their right of recruitment of those payments if there's a final determination of no coverage.

That's the only argument I have, Your Honor, on the primary argument for summary judgment.

I do want to briefly address their -- Axis's request for priority -- on priority of payments, if I may. Your Honor, in their opposition papers, Axis asks the Court to include a finding of priority of payments. They made that similar request with respect to the indicted officers' motion for preliminary injunctive relief. Your Honor, we believe that that request is improper. There's no pleading or motion before the Court requesting allocation or determination of priority as between the parties and that any order in this case in the event the Court grants summary judgment should remain neutral on the issue of priority payment so that payments can be made in accordance with the terms of the policy.

Unless Your Honor has any questions.

THE COURT: I may have questions of you after I hear

from the other parties, but right now, I don't.

MS. KIM: Thank you, Your Honor.

MR. WALSH: Good morning, Your Honor. Michael Walsh, Weil, Gotshal and Manges on behalf of the director defendants.

THE COURT: Good morning.

MR. WALSH: I concur in Ms. Kim's presentation. I just wanted to expand a little bit on the contract interpretation so not going to go through everything that she referred to.

It seems like, you know, when I look at all the pleadings back and forth when it comes down to those three little words "cover defense costs" and Axis is trying to read so much into that one word "covered," that undefined term basically that they can as a binding matter determine not to pay until everything is resolved in terms of coverage, the insuring agreements and exclusion. We think that that is an unreasonable interpretation. We think that it's putting too high a burden on one little undefined word.

Our interpretation is, as Ms. Kim said, which defense costs that on their face fall within the terms of the insurance agreement -- insuring agreement, require advance unless and until a court finally determines that coverage does not exist. Ms. Kim, you know, tracked through the various definitions to say that it falled within the insuring agreement.

So what we think is a better way to look at this is

almost a two-part test: Can the Court make a determination today that the claims fall within the Side A coverage? The insuring agreements which refer to claim loss, defense costs, and wrongful act, the answer is yes, the claim was covered; step two would be can the Court make a determination today that an exclusion applies. If the answer is yes, then the claim no longer falls within the policy coverage we're done; if the answer is no, then the claim remains covered for step one until such time as there is such a determination.

We think that's the only way to sort of reconcile all the language here, and we think that that's certainly consistent with the, you know, New York policy to give directors what sophisticated businesspeople would have expected in the D&O policy. We think it's certainly consistent with the WorldCom case, which although it turned on the issue of precision came out the same way requiring the advancement of defense costs pending a final determination on the rescission in question.

Axis tries to distinguish that case in two ways. First, they argue that the language in the WorldCom policy is materially different than what we have here in the U.S. Specialty policy, what we call the primary policy, but I think that is much too strained an interpretation. If you look at the language -- the advancement language in WorldCom, which starts off with the phrase "Under Coverage A and Coverage B the

insurer shall advance," I think the only reasonable interpretation of that is that it's referring to covered defense costs, that it is referring to defense costs that come within the insuring provision of Coverage A and Coverage B.

As I mentioned earlier, Axis also tries to distinguish WorldCom because it's a rescission case but, you know, we have to look at the ultimate result, Your Honor, and if whether it's rescission or the application of exclusion or any other theory which denies coverage. It's the same thing for the director defendants, so we don't think that's an appropriate way to distinguish that court.

So in summary, since we have -- we don't believe we have any facts that are in dispute here. We have the underlying litigation which falls within the definition of wrongful acts, et cetera, so the only thing that is left for the Court is this interpretation. And our position, Your Honor, is that the only reasonable interpretation is the one that we're giving to the policy. The only interpretation which would, in essence, give effect to the obligation to advance is our interpretation and we request the Court enter a judgment for us on the basis of a summary judgment.

THE COURT: What is on record showing that your clients dispute the exclusion, the fraud exclusion?

MR. WALSH: I think that we submitted statement of facts where we said that the underlying coverage comes within

the terms of the definition of the policy. I'm not sure we need to go any further than that.

THE COURT: Okay.

MR. EISEN: Good morning, Your Honor. Norman Eisen, counsel for Tone Grant and arguing on behalf of Mr. Grant, Mr. Bennett, and Mr. Trosten.

Your Honor, we have addressed the issues before the Court once, twice actually on preliminary injunction and twice again today, and we would rely on the arguments advanced by the previous counsel by Ms. Kim and Mr. Walsh and will not belabor the identical arguments for the Court. If the Court has questions for us at this time or later, of course, we're pleased to entertain them or if the Court would like to hear from us, we're prepared to do that, but we do stand on the identical arguments. They are the same -- it is the same policy and the same arguments.

THE COURT: Okay. Again, I may have questions for you after I hear from Ms. Gilbride, but right now I don't.

MR. EISEN: Thank you, Your Honor.

MR. JEROME: Excuse me, Your Honor. I note that nobody has raised an argument for Mr. Murphy. Ms. Kim left him out of the description of those to whom she was speaking. For the record I would just like to say I adopt all of the arguments, [inaudible].

THE COURT: Okay. All right. Thank you.

MS. GILBRIDE: Good morning, Your Honor. Joan Gilbride for Axis Insurance Company.

THE COURT: Good morning.

MS. GILBRIDE: Your Honor, we have submitted to Your Honor in an exhibit to our opposition to the motion for summary judgment a copy of the WorldCom policy. We submit that if you compare the relevant language, it's clear that the language in the Axis policy is different. WorldCom policy says that the insurer shall advance defense costs, then says in a separate place, they must advance defense costs. There's no requirement or no indication that those defense costs must be covered. The language in the Axis policy that makes the Axis policy materially different is the word "covered." And, Your Honor, frankly based on, you know, years and years of court interpretations that word "covered" has a meaning. It has a meaning to anyone who purchases insurance, anyone who writes an insurance policy. The word "covered" has a meaning. It can't just be deleted and excised from the policy, which is really what the insureds would like Your Honor to do.

And, you know, the way the word "covered" has been interpreted is that you must look at the insuring agreement. The insuring agreement has to be triggered. Then you look at the exclusions and what's left after you look at the insuring agreement minus exclusions is what's covered, so the Court must look at both. There must be a trigger of the insuring

agreement and the complaint must not fall within the exclusions.

Your Honor has previously ruled that Axis's request that the exclusions be considered has to be litigated elsewhere. It can't be litigated now. It overlaps with the underlying securities case and, you know, so Axis is precluded on that basis from litigating the applicability of the exclusions. But I think Your Honor hit it right on the head when you asked, what is in the record by these insureds to show that the exclusions don't apply. We submit it's their burden on summary judgment to make that argument and that argument has not been advanced.

In fact, we've made the argument that based upon the (8)(k) where Refco essentially admitted that there were undisclosed receivables that disclosed -- that admission is an admission of guilty knowledge on the part of Mr. Bennett. Mr. Bennett signed the warranty. Mr. Bennett, you know, warranted to the insurer that there was no information at the time he signed that warranty on behalf of all of the insureds, that he had any knowledge or any potential claims.

Your Honor has already ruled that we can't get into that and so, you know, we haven't extensively briefed that, but certainly these insureds have not put anything before the Court to support their position that defense costs should be covered.

THE COURT: Well, let me explore that a minute. The

Klejna group has done that, right? They say in their complaints, which they attach, their cross-claims, that Axis inserted the knowledge exclusion after the fact improperly. They also say that the issue of the fraud and its imputation to any of the insureds is at issue in the District Court litigations.

MS. GILBRIDE: Your Honor, that is absolutely in their counterclaim. It's our understanding based upon your prior ruling that those issues were either not to be explored at this point, but they certainly have not been advanced for summary judgment purposes.

THE COURT: Well, no, but I'm going to get to that in a second. I mean, is there any doubt from the record -- and I guess I was thinking about the question I asked Mr. Walsh, his clients did move, as did Mr. Eisen's clients, to dismiss Axis's complaint on the basis of the overlap doctrine. Those motions to dismiss are in the record and they state that the issues on fraud and the warranty will be determined in the District Court actions.

So I think their point is that once the Court sees that there is a dispute as to coverage and/or the applicability of an exclusion and/or the right to rescind, the advancement of defense costs needs to continue until that dispute is resolved by judicial order, and I think that's their point rather than that it has to be resolved now.

MS. GILBRIDE: Well, Your Honor, we disagree with that point. We believe that in order to prevail on summary judgment with respect to advancement, the insureds -- all the insureds have to show that the defense costs are covered and to show that there is coverage there has to be not only a trigger of the insuring agreement, but also there -- the exclusions must not apply, so I think their argument puts the cart before the horse. There has to be --

THE COURT: What case supports that?

MS. GILBRIDE: Your Honor, I think if you look at the Carlin Equities case, I think if you look at the Tyco case, I think if you look at Schiff v. Flack, which is a New York Court of Appeals in 1980, it's clear that the word "covered" is construed --

THE COURT: No, I'm talking about the more narrow issue, which I think is the issue here, which is the issue of whether there's an ability to withhold defense costs pending the determination of a coverage dispute.

MS. GILBRIDE: As far as Axis is aware, the only case that we've been able to find that deals with the precise language in the Axis policy, and I don't think it answers the question that you've just raised, is the Carlin Equities case. I don't believe that there is a case. I'm not aware of any case that addresses that precise question, but we believe that the language of the policy, and based upon contract

interpretation principles and insurance contract interpretation principles that our argument, which is that you have to look at those, the insuring agreement and the exclusions is supported by those principles and by, you know, case law which doesn't just deal precisely with this factual scenario, but it deals with the contract interpretation of principles that must -- that have to guide the Court's interpretation.

THE COURT: Okay.

MS. GILBRIDE: And, you know, again just to emphasize in the WorldCom case, the posture of that case before the District Court was entirely different than we're in. In that case, the insurers were seeking to rescind the policy and there was no dispute as to coverage, so I don't believe that there's any case that supports the position that's being advanced by the insureds either. It's simply an issue that perhaps precisely has not been addressed.

Your Honor, we believe our interpretation of the policy is reasonable. We think, you know, under basic contract interpretation principles that the Court should enforce the policy as written and on that basis we believe that the motion for summary judgment should be denied.

THE COURT: Okay. On the contract interpretation principles, you didn't really address this I think in your brief, but I'll give you a chance to address it now: what is your response to the statement in the movants' papers in which

they rely upon WorldCom, as well as three Second Circuit opinions which state that, in the absence of extrinsic evidence, where there is an ambiguity, it must be read against the insurer?

MS. GILBRIDE: Your Honor, I think we've cited several Second Circuit cases which make it clear that if intent is a question of fact, if there's a dispute as to intent, if there are two reasonable interpretations of a policy that that is a question of fact that precludes summary judgment.

THE COURT: But are those insurance company cases that deal with this where there was no evidence of any -- no extrinsic evidence for interpreting an ambiguity?

MS. GILBRIDE: Yes, Your Honor. We've cited insurance company case -- the Parks case, Second Circuit case, and several other cases we cited deal with the interpretation of insurance contracts and those courts hold that if intent -- well, they say that if there's -- if the Court finds that there's an ambiguity, that the Court must look at extrinsic evidence. We've not made this motion for summary judgment. The insureds have. It's their burden to establish one way or the other whether there's an ambiguity or not an ambiguity. They've taken inconsistent positions on that, but if the Court finds there's an ambiguity, the Court is obligated to look at extrinsic evidence. It's not our burden to put that extrinsic evidence before the Court.

Our position is that there's no ambiguity, Your Honor. Our position --

THE COURT: Let me explore that. Why do you say that it isn't your burden to put extrinsic evidence before the Court, given the statements in the case law that say that in the absence of extrinsic evidence an ambiguity will be construed against the insurer?

MS. GILBRIDE: Your Honor, our fundamental position and the position we've advanced from the beginning of this case is that the policy language is clear and unambiguous.

THE COURT: No, I understand that point, but I'm just going to the other point.

MS. GILBRIDE: Okay. So the insureds have argued or some of the insureds have argued that there may be an ambiguity. I think essentially that's what they're saying and I am not aware of any case law that says it's the insurer's obligation to establish the insured's argument that there's an ambiguity. Our position is that there's no ambiguity.

And if they want to argue that there is an ambiguity, I think it's their burden to put that information before the Court. Just for the record, it's not our -- the primary policy with this language, which we are arguing is clear and unambiguous was not a policy drafted by Axis, so we don't have -- it was drafted by another insurer, the primary insurer, so we don't have Axis without, you know, subpoenas or, you

know, some discovery to find out what exactly was in the mind of the drafter and that's the type of discovery that would normally occur if the Court was to find there was an ambiguity.

This -- you know, we're before Your Honor on a very expedited schedule, on a very fast pace, and that's all been at the request of the insureds. Our position is if we -- you know, we think the language is clear. We don't think it's ambiguous, so we don't want to point to extrinsic evidence to support their position.

THE COURT: Okay.

MS. GILBRIDE: Do you have any other questions for us, Your Honor?

With respect -- I think Your Honor is aware of this, but the other argument advanced by Mr. Klejna's counsel that the carriers below us had the same language and that they --

THE COURT: They don't have the exclusion you have.

MS. GILBRIDE: Exactly. I don't think I have anything else. Thank you, Your Honor.

MS. KIM: Well, Your Honor, just briefly.

THE COURT: Well, I'm sorry, but --

MS. KIM: Oh, I'm sorry.

THE COURT: Is there any issue -- if I ruled in favor of the movants here, what would be the consequence? It would be payment, right?

MS. GILBRIDE: Yes, Your Honor.

THE COURT: Okay. All right. You can go ahead, Ms. Kim.

MS. KIM: Well, Your Honor, it's our position the -- that the terms of the policy are clear and unambiguous and that if there were a -- that there is no provision in the policy that gives Axis the unilateral right to make an initial determination of the application of an exclusion. In fact, I was reminded of that commercial from the '80s, "Where's the beef?" They kept saying the terms -- this policy expressly provides that Axis can make that initial determination. I don't see that anywhere. They haven't cited any provision anywhere.

We believe that in order to have a second sentence of condition (d)(2) apply, the recoupment provision, the repayment provision, the only way that provision ever has any meaning whatsoever is if Axis has an obligation to pay defense costs that are disputed until there is a final determination of no coverage. Otherwise, Your Honor, they would never -- they could simply disclaim coverage. They would never even have to reserve -- pay defense costs under a reservation of rights. That scenario would never arise, because under their reading they could just disclaim coverage and there would never be any advancement of disputed defense costs, Your Honor.

So we believe it is their burden to come forward with extrinsic evidence. They didn't do so, and therefore we

believe that the contractual interpretation is clear. There has to be advancement of defense costs until there is a final determination -- excuse me -- of no coverage.

We note that in the Carlin Equities case there was a determination with respect to the application of an exclusion for one of the insureds. That was Mr. Mochweller [Ph.]. But that was a determination made on summary judgment from the face of the pleadings. The reason he was excluded was because it was -- he was admittedly not an officer or director of Carlin and he didn't fall within the management carve-back provision. That was a determination that the Court could make from the face of the pleadings to which there was no dispute. And I believe that Axis also raised -- posited a problem, an issue. They said, well, the policy also has -- the Axis policy has an exclusion for any case arising out of the McElreath [Ph.] case.

Well, if we had submitted and tendered a case that was squarely brought into issue, the allegations of the McElreath case, they could have moved for summary judgment on the face of the pleading saying, no, that's not covered, but they can't do that here, Your Honor. They have not crossed move for summary judgment, because there is a disputed question as to the underlying coverage applicability of exclusion and I agree with Mr. Walsh's two-part test.

If there is an exclusion and the Court cannot determine from the face of the pleadings that the underlying

action falls entirely within the scope of that exclusion, then the burden remains on the carrier to advance until that underlying question is resolved in the underlying action.

MS. GILBRIDE: Your Honor, can I just address some of the arguments that have been advanced?

THE COURT: Well, does anyone else have any response on it before I hear from Ms. Gilbride?

MR. WALSH: Just a couple of little things, Your Honor. Michael Walsh, Weil, Gotshal.

You asked me a question earlier about, you know, is there facts in this record about the director defendants denying that the exclusion applies. I'm still not sure if that's, you know, relevant to the discussion but it is a matter of judicial record that we have filed answers to, you know, the complaints in the underlying action where we did deny all those allegations.

On point of ambiguity, we're certainly not arguing that the language is --

THE COURT: I'm sorry, did you answer? I thought you moved to dismiss. Did you answer also?

MR. WALSH: In the underlying actions.

THE COURT: Oh, I understand. All right. The federal -- the District Court actions?

MR. WALSH: yes.

THE COURT: All right.

MR. WALSH: On the issue of ambiguity, we're not taking the position that the language is ambiguous. We think it is unambiguous, but if the Court has to get to that issue, we think that it -- that Rule 56(e) requires Axis to say something about it. This was their policy. It's not like advancement is some little tiny provision, you know, in the fine print. Advancement is sometimes that's the whole purpose of the contract. Though they were not the drafters of the primary policy, they signed onto the terms of the primary policy. They've got anything whether it's -- what their intent was, they should have come forward and they didn't, so I think having failed to do that, Your Honor, you could go on -- you could if you were so inclined rule in our factor in terms of summary judgment based on ambiguity, but that's not our argument.

THE COURT: Okay. Okay. I think they're done.

MS. GILBRIDE: Okay. Sure. Just addressing a couple of things that Ms. Kim argued, Your Honor.

She argued that the second sentence of (d)(2) would be superfluous if our position with respect to the first sentence was adopted by the Court. That's just not accurate.

The second sentence of (d)(2) applies in a situation, the exact situation that the primary and first Axis carriers are in where they have advanced defense costs subject to a reservation of rights based on other exclusions, not the same

exclusions as us, which require that there be an adjudication in fact of the issues in those exclusions.

So the purpose of the second sentence of (d)(2) is for those situations where an insurer says, well, we don't think there's coverage but we can't make that determination now based upon the language in those exclusions so we will advance defense costs subject to a reservation of rights and subject to recoupment later if there is an adjudication that satisfies the language of those exclusions.

The exclusions that Axis is relying upon do not have that language and, in fact, the argument that's being advanced by the insureds, by some of the insured is -- would make that second sentence of (d)(2) superfluous and it would make the language of the exclusions that require an adjudication in fact superfluous. Their argument -- so in order to reach the conclusion that they're advancing you'd have to ignore the word "covered" before defense costs and you'd have to ignore the other provisions in the policy which provide mechanisms for reimbursement in the event that there is an exclusion which requires an adjudication in fact.

And, you know, then there's (d)(3), Your Honor, which, you know, if you adopt the argument that the insureds are advancing basically it would have been in Axis's interest to say, well, we think one percent of this case is covered, so we'll advance one percent of the defense costs. And they would

say, well, 100 percent is covered; (d)(3) would only require us to advance undisputed defense costs and that can't be the way that this works. That just makes no sense whatsoever.

THE COURT: Although that's how the District Court in the Rigas [Ph.] case determined it.

MS. GILBRIDE: Your Honor, I don't think -- I'm positive that the Rigas policy language did not have the word "covered defense costs." That was not there.

THE COURT: But on that point, I mean, all of these policies, including the WorldCom policy, allowed the insurer to make the argument that this wasn't covered in some way or another, either in the definition of a "loss" or "injury" because it's a loss "under the policy" and so I just -- I'm of a mind that you're putting too much weight on the word "covered," because an exclusion is an exclusion. I mean, you don't have to say to someone else "if we really meant it, it's an exclusion" and these cases all deal with exclusions and say, well, if there's an issue about an exclusion, then sorry, insurer, you have to wait until that's determined and advance the defense costs beforehand.

MS. GILBRIDE: Well, Your Honor, I think that that is the position that most insurers thought was the law before you had WorldCom and Tyco. And I think if we do get into extrinsic evidence, it will be very clear that the word "covered" was put right where it was based upon the court interpretations that an

insurer could not rely upon its own interpretation of its own policy language. So that word "covered" is significant.

THE COURT: But is there any -- but that's just speculation, right?

MS. GILBRIDE: I -- yes.

THE COURT: Okay.

MS. GILBRIDE: It is not -- it is speculation.

THE COURT: All right.

MS. GILBRIDE: But it's based upon knowledge of, you know, how these policy language have -- policy provisions have developed.

THE COURT: Well, no one has asserted that, though.

MS. GILBRIDE: I'm not an expert witness. I'm not here before the Court as an expert witness.

THE COURT: Okay.

MS. GILBRIDE: No.

THE COURT: Well -- all right.

MS. GILBRIDE: But I think that -- I think that you're right that insurers thought that that was the way it worked.

THE COURT: I didn't say that.

MS. GILBRIDE: Before -- well, I think that, you know, it was a reasonable interpretation of the WorldCom policy to think that if there was an exclusion advanced that you could rely upon your interpretation of the exclusion and there was no

need to use the word "covered" before defense costs.

So if you will, the word "covered" was inserted to make it triply -- you know, very clear to anyone who looks at it --

THE COURT: Well, again, I --

MS. GILBRIDE: -- that in order for there to be advancement --

THE COURT: I mean, if it's on its face, if it's really clear, I mean, again, I go with the judge in the Rigas case. He seemed to think that you needed to be a lot clearer than that, and then he made his somewhat offhand remark that perhaps the insurers didn't do that because it would affect their ability to sell policies, but --

MS. GILBRIDE: Your Honor, I read that dicta as well. You know, of course, I read that. I don't think that, you know, it's neither really here nor there nor the issue that we have today.

THE COURT: Okay.

MS. GILBRIDE: You know, our position is that the language is clear.

With respect to Mr. Walsh's position with respect to the -- whether they've denied that the exclusion applies, I don't think that there's -- I'm not aware of anything in the underlying action that involves the exclusionary language. I'm certain that his clients have denied that there's a fraud, but

I don't think that that is enough evidence to establish that they've denied that the exclusion applies.

THE COURT: Well, but didn't they say in their motion to dismiss that under the overlap doctrine I couldn't decide this coverage issue because the underlying issue of the fraud was at issue in the District Court actions?

MS. GILBRIDE: They did. They did make that argument.

THE COURT: Okay.

MS. GILBRIDE: Our position is not -- is not based on fraud. We don't -- you know, we're not basing our coverage position based upon a fraud exclusion. It's based upon a prior knowledge exclusion and a warranty.

THE COURT: But it's a prior knowledge of fraud.

MS. GILBRIDE: It's a prior knowledge of facts or circumstances that could lead to a claim. It doesn't have to be prior knowledge of a fraud. It so happens that in this case apparently -- you know, there are allegations that it was apparently a fraud, but that's not what the exclusion or the warranty letter said. It's just knowledge of acts or circumstances.

THE COURT: All right. But there -- I mean, there's no dispute that it has to be wholly within the exclusion to be excluded, right? I mean, the cases are pretty clear on that.

MS. GILBRIDE: Yes, Your Honor.

THE COURT: So, for example, if there's a dispute about fraud and there be one of the counts, of the ones that are being sued, is a fraud suit, then it would seem to me it would -- they'd be denying it, but the exclusion applies.

MS. GILBRIDE: Well, I don't read it that way, Your Honor, but --

THE COURT: Okay. Can I turn to the cross-motion for a declaration that if I were to grant the movants' motion, the insureds' motion, it's subject to refund?

MS. GILBRIDE: Yes, Your Honor. That's an argument that Axis is advancing.

THE COURT: What is -- I mean, is -- it's not -- to me it doesn't seem to be an issue now, so you have to, I think, rely on the other basis for a declaratory judgment that somehow your actions are adversely affected by not knowing the answer to that question. I just -- how would that -- how is that the case here?

MS. GILBRIDE: Well, Your Honor, we believe that Your Honor made it clear that you could interpret the policy. You could construct the policy as a matter of law. We're simply asking the Court to construct the policy the same provision that the insureds are relying upon to say that they -- that defense costs should be advanced, that if they are advanced, they should be repaid if there's an ultimate determination.

THE COURT: Well, but the issue is whether it's ripe

to do that at this point.

MS. GILBRIDE: Well, it's certainly Axis's position that the issue is ripe. You know, Axis is being asked to advance defense costs where Axis's position is if there's no coverage for the defense costs and Axis issued a policy that says in that situation a second sentence of (d)(2) that if there is an ultimate determination that there's no coverage that Axis is entitled to repayment.

THE COURT: But why -- well, why is this different than cases like WorldCom and Koslowski? Well, or the G-1 Holdings case, where the courts all say as part of their analysis of the contract that the bargain here was to advance the defense costs subject to reimbursement under the provision which has the same language in it essentially that this contract has in (d)(2) that if it's later determined that it wasn't covered that it be reimbursed. I mean, that -- those weren't declaratory judgments. Those were statements as part of the rationale of the court's decision in interpreting the contract.

My question goes to why does -- why should I be issuing a declaratory judgment on top of that when I don't know, for example, when there's no request or no refusal -- put it that way, no refusal, first, and then no request to enforce the contract in light of the refusal, to refund the advanced defense costs?

MS. GILBRIDE: Just addressing your first question, Your Honor, I don't know that a declaratory ruling was requested in those cases that Your Honor is referring to, so for that reason it may not have been addressed by those courts.

THE COURT: Right.

MS. GILBRIDE: Our position is that just simply based upon the Court's inherent power to interpret these insurance policies that Your Honor has the power to say that in the event that it is finally determined that these defense costs are not covered, that they should be reimbursed.

THE COURT: Okay.

MS. GILBRIDE: And it's based upon, you know, the federal declaratory judgment action.

THE COURT: Well, I guess that's where I'm having a problem. I don't see how it is really based on the federal declaratory judgment statute since there's no immediate controversy and I'm not hearing any argument that there's the type of doubt in Axis's mind that the contract wouldn't be interpreted the way Axis says it should be interpreted. I mean, no one's --

MS. GILBRIDE: Well, there's a lot of doubt in Axis's mind about that, Your Honor.

THE COURT: Well, where is that stated? I didn't see that. Where is the -- where's that hook under the declaratory judgment act?

MS. GILBRIDE: Your Honor, I think if you look at the broad powers that are enumerated in that statute, that would -- you know, it's our position that Your Honor does have the power to issue --

THE COURT: All right. I know you said that.

MS. GILBRIDE: -- that sort of --

THE COURT: But I'm not satisfied by that. I need to hear why I need to do it, because I think I only really have the power if I need to do it.

MS. GILBRIDE: Your Honor, we've, you know, cited in our papers the relevant provisions of the statute. If Your Honor doesn't agree with that cite, you know, I don't know what more I can say to convince Your Honor of that.

THE COURT: Okay. All right. Okay.

MS. MOSES: Barbara Moses, Your Honor. I represent Mr. Trosten. Very briefly, just on the last point, the cross motion for an additional declaration of rights under the policy. What Your Honor said was that you didn't think you had the power to do it unless you needed to do it and I think that's exactly right. I would approach this issue not so much from the point of view of ripeness, but more fundamentally from the question of whether there is even a justiciable controversy here. That's a constitutional requirement before a declaratory judgment may be issued. Since there has been no demand for repayment, no refusal to repay, no showing or suggestion of

anything other than a doubt in counsel's mind as to whether such a dispute ever would develop in the future, I don't think we have a justiciable controversy here. Thank you.

THE COURT: Okay.

MR. KLINE: Your Honor, Ivan Kline for Sexton and Sherer. I think Your Honor has already recognized that Ms. Gilbride's statement was just pure speculation, but just so the record is clear, it's not only speculation but on the face of the document she submitted it's -- herself to the Court -- it's wrong in terms of the sequence of how the word "covered" arrived in this policy, since in the Carlin Equity case that she -- that she submitted on Wednesday, the court made clear that that -- which is the identical policy language in the identical primary carrier, that policy was written in 2003, so the language that started here in August 2005 was not a response to WorldCom and Koslowski. It appeared in 2003 and was continued following the Koslowski decision in 2004 and the WorldCom decision in February 2005.

THE COURT: Okay.

[Pause in the proceedings.]

THE COURT: Where's the date of that policy stated in here in the Carlin opinion?

MR. KLINE: The very first paragraph of the opinion, Your Honor. It says in 2003 Carlin purchased a directors & officers [ph.] and that is the policy where the -- on the

same -- I think Houston Specialty -- Houston Cad [Ph.], I believe, is the same company as U.S. Specialty.

THE COURT: Okay.

MR. KLINE: It's the same language that is in the primary policy.

THE COURT: Okay.

MS. GILBRIDE: Your Honor, it was pure speculation on my part.

THE COURT: Okay. All right.

[Pause in the proceedings.]

THE COURT: All right. I have before me in this adversary proceeding motions for summary judgment in respect of the claim that Axis Reinsurance Company is obligated to advance defense costs to the insured's under its excess liability policy on behalf of directors and officers of Refco, Inc.

The movants, all former directors and officers or officers of Refco, are Messrs. Klejna, Sexton, Sherer, Silverman, and Murphy, Messrs. Brightman, Gantcher, Harkins, Jackel [Ph.], Lee, O'Kelley and Shone [Ph.] and Messrs. Grant, Trosten and Bennett. I believe that includes all the moving insureds.

Federal Rule of Civil Procedure 56(c), which is made applicable in bankruptcy proceedings in bankruptcy cases pursuant to Bankruptcy Rule 7056 controls the standard in respect to these motions for summary judgment. Rule 56(c)

provides that summary judgment shall be granted if the pleadings, depositions, answers to interrogatories and omissions on file together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Siltex Corporation v. Cantrent [Ph.], 477 U.S. 317 (322 1986).

In deciding a motion for summary judgment, the Court must determine if there are any material factual issues to be tried while at the same time since the nonmoving party would be precluded from a trial if the relief were granted the Court should resolve ambiguities and draw reasonable inferences in favor of the party opposing the motion. Matsushita v. Zenith Radio Corporation, 475 U.S. 574 (587 1986); Knight v. U.S. Fire Insurance Company, 804 F.2d 911 (2d Cir. 1986).

The burden ultimately rests on the moving party to establish the absence of a genuine issue as to any material fact, Siltex 477 U.S. at 322-23. The nonmoving party may oppose a summary judgment motion by making a showing that there's a genuine issue as to a material fact in support of a verdict for that party, Anderson v. Liberty Lobby, Inc., 477 U.S. 242 247-48 (1986). That is the mere existence of a scintilla of evidence in support of its position will be insufficient. There must be evidence on which a jury could reasonably find for the nonmoving party. Id.

That is, the nonmoving party may not defeat a summary

judgment motion by relying on self-serving or conclusory statements. There must be something more than some metaphysical doubt as to a material fact. That is, there needs to be specific evidence of a material fact at issue, although of course once that evidence is shown, the Court moves on to the trial stage, that is, the evidence need not be probative at the summary judgment stage. See generally again, Matsushita v. Zenith, 475 U.S. at 586.

In this case the question before the Court is whether there's a genuine issue of material fact as to whether Axis' unilateral decision to deny payment of defense costs to the plaintiff insured's was a breach of the Axis policy. In determining that issue on summary judgment, the parties have directed me primarily to rely upon the terms of the policy and in particular the terms of the provision governing the advancement of defense costs, paragraph (d)(2), as well as various claims claimed, exclusions to the policy. They have submitted their statements of undisputed material facts and in Axis's case a response in certain instances controverting those statements.

In reviewing that record, it is clear to me that primarily this is a dispute upon which the Court must focus on the language of the relevant provisions of the insurance policy. Accordingly, this falls into the category as noted by numerous courts that summary judgment is a particularly

appropriate vehicle for determining insurance coverage disputes. See United Capital Corporation v. Travelers Indemnity Company of Illinois, 237 F. Supp. 2d 270, (274 S.N.D.Y. 2002). And that is because generally insurance company disputes hinge, as this one does, on the terms of the contract and contract determination generally leads itself or lends itself to summary judgment analysis.

I previously determined in this proceeding that the dispute in particular the interpretation of the contract under the dispute is governed by New York law having applied in New York law, choice of law analysis and determined, as I set forth on the record of the hearing on August 30, 2007, that New York choice of law principles given the locus of the dispute and generally speaking the domicile of the parties would lead to New York applying.

That transcript is attached to the parties submissions, both Ms. Kim's declaration as well as Ms. Gilbride's declaration in support of Axis's cross motion at Exhibit B.

Under New York law generally a contract -- a written contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language they've employed, Kruden v. Bank of New York, 957 F.2d 961 (976 2d Cir. 1992). Under New York law if a contract is unambiguous on its face its proper construction is a question

of law. The Court should not look beyond its confines to extrinsic evidence if its relevant provisions are clean and unambiguous. See generally Metropolitan Life Insurance Company v. RJR Nabisco, Inc., 906 F.2d 884 (889 2d Cir. 1990); WWW Associates, Inc. v. Gencontiari [Ph.], 77 NY 2d 157 (162 1990); and Vermont Teddy Bear Company, Inc. v. 538 Mass Realty Company, 1 NY 3d 470 (2004).

Giving the terms of the contract their plain meaning, a court should find contractual provisions ambiguous only if they are reasonably susceptible -- if they are reasonably susceptible to more than one interpretation by reference to the contract alone. Crummy v. Westpoint Stevens, Inc., 238 F.3d 133 (139 2d Cir. 2000). Contract language is unambiguous if it has a definite and precise meaning unintended by danger of misconception in the purport of the contract itself concerning which there's no reasonable basis for difference of opinion. Metropolitan Life Insurance v. RJR Nabisco, 986 F.2d -- excuse me -- at 889, language whose meaning is otherwise plain is not ambiguous merely because the parties urge different interpretations in the litigation. Id.

Those contract interpretation rules are generally followed in New York in respect of insurance policies, but in addition to those general principles there are specific contract interpretation rules that apply to insurance policies that are relevant to this dispute or potentially relevant.

With regard to the first proposition that with regard to the interpretation of the insurance contract, the courts view the plain language of the contract as the best and if plain the only measure of the parties intentions and that the initial interpretation of the contract is a matter of law for the Court to decide is set forth in among other decisions cited by the parties. In Re: WorldCom, Inc, Securities Litigation, 354 F.Supp. 2d 455 at 463 (464 S.D.N.Y. 2005).

However, in that opinion District Judge Cote goes on to state real established rules with regard to insurance contracts, in particular in New York. That is, first that to the extent an ambiguity exists in respect of an insurance contract governed by New York law and is unresolved by extrinsic evidence, such ambiguity is read against the insurer. See also Nekostis v. Home Insurance Company of Indiana, 31 F.3d 910 (113 2d Cir. 1994). Going on, Judge Cote says the rule that insurance policies are to be construed in favor of the insured as most rigorously applied in construing the meaning of exclusions incorporated into a policy of insurance or provisions seeking to narrow the insurer's liability.

Finally, under New York law where a contract of insurance includes the duty to defend or to pay for the defense of its insured and I note that Judge Cote makes no distinction between the two concepts, *i.e.*, duty to defend or duty to pay for the defense of its insured, that duty is "a heavy one" and

indeed has been found for many years to apply even if the policy of indemnity does not specifically provide for advancement.

"In sum" -- again, I'm quoting from the WorldCom opinion at page 464 -- "the duty to pay defense costs is construed liberally and any doubts about coverage are resolved in the insured's favor." My review of Axis's statement of additional facts and response to statement of undisputed material facts submitted in response to various of the movants, Rule 7056(1) statements that most of the issues in this case are uncontroverted, obviously, the terms of the underlying policy which incorporates with the specific exceptions stated in the Axis policy the primary policy issued by the primary insurer.

In addition, Axis does not dispute that the underlying litigation against the insureds constitutes claims as a defined term for wrongful acts as defined in the primary policy or that the movants here are insured or are insureds or that they have incurred and will continue to incur defense costs under -- or in response to the underlying litigations.

There's also no dispute and of course the policy speaks for itself that the term "loss" in the primary policy as incorporated with specific exceptions by the Axis policy includes defense costs and insured person is legally obligated to pay as a result of any claim. It's also not disputed that

the insureds have given Axis notice on a timely basis of their claim of the policy.

What is disputed by Axis is first whether exclusions unique to its policy, which I primarily take to be the prior knowledge exclusion set forth in endorsement number six to the policy, but also other potential exclusions and defenses apply here to prevent the defense costs from being covered under the policy.

In addition, the parties dispute whether under the language of the primary policy specifically paragraph (d)(2) Axis is obligated to pay defense costs on an as-occurred basis in light of its contention that the exclusions that it has noted apply and preclude coverage. The issue was first raised by Axis. Apparently in a letter attached Exhibit 9 to the Kim declaration disclaiming coverage on the basis of various disclusions -- exclusions as well as breach of warranty.

Notably, Axis has not offered any material fact as to any extrinsic interpretation of paragraph (d)(2) that I've referred to or any other provision for that matter of the applicable insurance policies.

I conclude based on the record before me for purposes of these motions that, in fact, there is a dispute as to whether the policy exclusions would apply here to render the losses including defense costs not covered by the policies. Specifically, each of the movants, each of the insureds has in

this adversary proceeding taken the position that it is not precluded from coverage by the knowledge exclusion and furthermore certain of the insureds as set forth in Exhibits 10, 12 and 13 of the Kim declaration at paragraphs 43 through 45 and in addition taken the position that the knowledge exclusion itself is an improper endorsement to the policy.

I previously ruled as is set forth in the transcript of the August 30, 2007 hearing that the issue of whether, in fact, the insured's losses are covered under the Axis policy in light of the prior knowledge exclusion, as well as the other exclusions and defenses raised by Axis, may not be decided at this time in light of the substantial overlap of those issues, *i.e.*, whether in fact there was a prior knowledge of a claim and/or loss.

With the issues pending before the District Courts in the multi-district securities litigation as well as in respect to certain of the insureds pending criminal litigation in the Southern District, I won't repeat that ruling now except to note that in my view it was dictated by clear precedent which, as was brought out at the hearing and is set forth in the transcript, essentially puts the interest of the insured in having a prompt determination of such an issue behind the interest of the insured to pursue its defense of the primary litigation that allegedly gives rise to the claim or loss.

That context is important to keep in mind, however,

in connection with the present motions because it sets the stage for the -- what I believe to be fairly narrow issue before me. Again, that issue ultimately depends upon the Court's interpretation of the following provision, paragraph (d)(2) of the Axis policy which states incorporating the provision from the primary policy, "The insurer will pay covered defense costs on an as-incurred basis. If it is finally determined that any defense costs paid by the insurer are not covered under this policy, the insured has agreed to repay such noncovered defense costs to the insurer."

Axis contends that it is permitted by that language to determine unilaterally not to pay defense costs on an as-incurred basis if it believes that such defense costs are not covered under the policy, that is, that they would be subject to the exclusion or the exclusions under the policy. The movants contend to the contrary that Axis is obligated under the paragraph that I just read, particularly when construed in light of relevant case law and the presumptions that I noted earlier applying to exclusions and insurance policies generally to mean that until there is a final determination by an objective fact finder that the defense costs are not covered, Axis is obligated to advance them. They say this again because they contend and I conclude the record supports this that there is a legitimate dispute as to whether defense costs are covered or not under the policy.

Both sides have asserted principles of contact interpretation or a principle of contract interpretation to assist the Court in determining whether the language that I just quoted is ambiguous or not. Not surprisingly, they both contend that the language is not ambiguous, although equally not surprising they both contend that it means the opposite of what the other says it means.

The principle they relied on primarily is that a court should read a contract in whole giving meaning to all of its parts and avoid interpretation that would render other provisions useless and meaningless and I have looked at the other provisions of the contract, in particular, paragraph 3 as well as the interplay of the two sentences in paragraph (d)(2).

Frankly, after having done so, I do not believe that the contract interpretation maxim that I just recited is of much help in that one could conceive of uses for the language in paragraph (d)(2) to support both sides' position. I believe that (d)(3) is really a provision going to a separate proposition and consistent with, again, the principles pursuant to which courts in New York interpret insurance policies and particularly exclusions to the advancement of defense costs, (d)(3) should be read narrowly and not be used to extend over into interpretation of (d)(2).

However, there is a more meaningful point to note about the rest of the policy, which is that nowhere does it

state that or imply except in (d)(3) in the specific instance covered thereby that the insurer can unilaterally or in the exercise of its reasonable judgment or in any other way withhold defense costs absent a court determination in the event of a dispute as to whether defense costs are covered.

In light of the case law that I will go into in a minute, as well as the function of advancing defense costs, I conclude that the absence of such language in addition to the language of (d)(2) says that "The insurer will pay and provide for refund mechanism if noncovered defense costs are finally determined. "Not to be covered" means that the reasonable and ordinary course colloquial interpretation of paragraph (d)(2) is that absent a final determination by an objective fact finder the insurer is obligated to pay the defense costs notwithstanding its view that those costs are excluded under the policy.

As I said, I believe this language is clear in the context of the entire agreement and it's in the absence of that agreement of any provision conferring on the insurer the unilateral ability to make such a determination, but I note to that to the extent that an ambiguity exists the insurer has offered up no extrinsic evidence in support of its position for interpreting paragraph (d)(2). Consequently, I believe that under the law of New York in the absence of offering up such evidence the ambiguity would have to be interpreted against the

insurer. Again, see Macostis v. Home Insurance Company [inaudible], 31 F.3d 110 at 113 2d Cir. 1994, as well as the discussion in Multi-Foods Corporation v. Commercial Liens Insurance Company [Ph.],309 3d 76 (8807 2d Cir. 2002).

As I alluded to a moment ago, I'm not writing on a clean slate with regard to this issue. As far as I can tell, every court that has considered the issue and again I believe it's a narrow issue as to whether during the pendency of a dispute as to coverage under the policy an insurer may withhold the payment defense costs has concluded that to the contrary the insurer is obligated to advance the defense costs with the caveat that if it is clear from the policy itself and claim made against the insured that the claim would not be covered then such an obligation could be decided on a summary judgment basis and no defense costs would need to be advanced.

Here as I noted, that issue is not clear. Consequently, I believe that the case law would support my conclusion that Axis is obligated to advance the defense costs. This issue has most recently been dealt with more thoroughly in Federal Insurance Company v. Tico International Limited, 784 NYS 2d 920, in which the Court after noting numerous cases that considered the issue in other jurisdictions found that it is "... well settled the duty of insurer to defend its insured or pay its defense costs as distinct from and broader than its duty to indemnify. The duty exists whether a complaint against

the insured alleges claims that may be covered under the insurer's policy. If any portion of a complaint might result in coverage, the insurer must defend or pay defense expenses for all claims, both covered and noncovered. Conversely, the insurer has no duty if as a matter of law the allegations in the complaint could not give rise to any obligation to indemnify or the allegations fall within the policy exclusion, but the duty to defend or pay defense costs is construed liberally and any doubts about coverage are resolved in insured's favor. Furthermore, an insurer can only evoke a clause exclusion to avoid coverage if it can show that the allegations in the complaint as to pleading solely and entirely within the policy exclusion."

Given the doubt raised by the movants, the insureds in that summary judgment motion as to whether the insurer had met those stringent tests, the Court concluded that pending a final determination of those issues the insurer would need to advance defense costs. I note that it did so notwithstanding similar facts alleged as to at least one of the defendants alleged fraud which were arguably analogous at least to the conduct of Mr. Bennett.

The New York courts have twice since the Koslovsky opinion adopted its rationale, although in one case apparently in dicta in Ghose, G-h-o-s-e, v. CNA Reinsurance Company Limited, 841 NYS 2d 519, Appellate Division First Department

2007 the Court stated, "We note, however, that the complaints ere not being dismissed on grounds of inconvenient form. The interim order defense costs would not be disturbed. New York law requires that a judicial order is a condition precedent to the cessation of payment for defense costs and circumstances where a claim has already been made" citing Koslovsky.

Similarly, in Trustees of Princeton University v. National Union Fire Insurance Company of Pittsburgh, 839 NYS 2d 437 (Supreme Court, New York County, 2007), the Court after noting many of the same rules of construction that I quoted from the Koslovsky case stated the insureds -- I'm sorry, the insurer's duty to pay defense costs arises when the insured incurs the expenses. Where coverage is disputed, insurers are required to make contemporaneous interim advances of defense expenses subject to recoupment in the event it is ultimately determined the policy does not cover the claim.

A similar finding, albeit in respect of slightly different language was reached by Judge Cote in the WorldCom opinion that I cited earlier. Axis has attempted to distinguish the WorldCom opinion on two bases, neither of which I conclude succeed. The first is that Judge Cote was dealing with a defensive rescission as opposed to a specific exclusion in the policy. I don't accept that distinction because I believe that in either case, the key point was that there was a dispute as to whether there was any obligation to pay on the

insurer's part.

The second basis is that the advancement language in the policy in WorldCom did not contain the word "covered" before defense costs. And I gather used the word "shall" as opposed to "will" before the word "pay." But for the same reason that I don't believe the first distinction is meaningful, I don't believe the second one is either.

In either case, the issue hinged upon whether the insurer could unilaterally act to withhold payment based on its interpretation of whether it was obligated to pay a coverage or whether the policy was void ab initio. I believe Judge Cote's logic would apply under either scenario.

The issue was addressed -- the issue that I just discussed was addressed expressly by the District Court for the Eastern District of Pennsylvania in Associated Electric and Gas Insurance Services Limited v. Ritas, 382 F. Supp. 2d 685 (E.D.P.A. 2004). Because of a prior Third Circuit opinion, the Court in the Regius case had little trouble finding that the insurer's rescission allegation did not give it the unilateral right to withhold defense costs relying instead upon Little v. MGIC Indemnity Corporation, 836 F.2d 789 (3d Cir. 1987).

The Court separately considered however whether a unilateral right existed in respect to advancement of defense costs because of applicable exclusion from coverage including a prior knowledge exclusion, which like this exclusion did not

require a final adjudication for the exclusion to take effect. As here, however, the Court in the Regius case noted that the prior knowledge exclusion also does not contain any language to suggest that it operates at the discretion of the insurer.

In the Regius case, the Court determined that the carriers had a duty to contemporaneously pay defense costs given the language in respect of defense costs and the indemnity policy generally triggering an obligation to pay wherever the insured was legally obligated. As here, there was no dispute in the Regius case that the insureds owed money to the lawyers defending in civil suits and that this was a legal obligation. Thus, the carriers had a duty to contemporaneously pay defense costs and it's altered by other language in the policy.

The Court concluded that the knowledge exclusion was ambiguous because it settled two different interpretations as to whether a unilateral right was lodged in the insurer and since Pennsylvania law was similar to New York law, it must be construed in favor of the insureds and against the insurers. Here, as I said, I go further and find that the absence of such a provision in light of paragraph (d)(2) means that (d)(2) is not ambiguous, but as I said before based on the absence of any extrinsic evidence offered to clarify any alleged ambiguity, the provision would be construed in favor of the insureds and against the insurer here.

Two other recent cases from other jurisdictions which generally have the same basic insurance law contract interpretation principles also worth noting, first, G-1 Holdings, Inc. v. Reliance Insurance Company, 2006 U.S. District Lexus 17597, District of New Jersey, March 22, 2006, where the Court concluded that although the defendants argue that various exclusions operate to bar the potential that the underlying claims will be covered, "An insurer's duty to defend is determined by comparing the allegations of the underlying complaint with the language of the policy at issue. Here, the Court has already found that there is a potential for coverage should the alleged facts prove" -- I'm sorry -- "be proven true particularly where again as here the policy provides that if it does not apply" -- I'm sorry -- "that is later adjudicated that it does not apply to the underlying allegations, the policy specifically provides that the insurer would be reimbursed. The insurer is obligated where there is a reasonable potential for coverage to advance the defense costs."

The Court in Sometimes Media Group, Inc. v. Royal and Sun Alliance Insurance Company of Canada, 2007 WL 1881 265, Del Super June 20, 2007 makes a similar point. "Furthermore, the personal exclusions do not override a present contractual duty to advance defense costs unless the defendants can unequivocally now show that all of the obligations in the underlying class action complaint fall within the personal

conduct exclusions. Since the defendants have failed to show at this time the applicability of exclusions to International, the Court need not decide the potential applicability of exclusions at this time."

Again, the Court noted that the policy provided as paragraph (d)(2) does here "Such advance payments by the insurer shall be repaid to the insurer to the extent that any such insured shall not be entitled under the policy ultimately to such payment." And then it concluded, "Therefore, the plain language of the policy guaranteeing an advancement of defense costs is not precluded by an imputation of exclusions to International as well as explained earlier to the outside directors."

In light of that case law, I conclude that under the language of the policy concluding its incorporation of the extensive case law regarding how such policies are to be interpreted in New York that pending a resolution of the coverage dispute Axis is obligated to advance defense costs. That is, in some instances an issue that the Court could and does decide promptly here because of the substantial overlap document it cannot be decided by me, but that is not a reason for changing the rule that I have just articulated. As is again, I believe, supported by the Regius case from Pennsylvania where the District Court was precluded by the automatic stay in the Adelphia bankruptcy cacaos from deciding

a coverage issue and nevertheless concluded that the insurer was obligated to advance the defense costs. So for those reasons, I will grant the insured's motions for summary judgment.

Let me turn then to the cross motion for summary judgment by Axis, which seeks a declaratory judgment that if, in fact, it is subsequently determined by a court that the defense costs are not covered, i.e., that an exclusion applies or for some other reason they're not covered by the policy, the insureds to have received the defense costs are obligated to repay those costs to Axis.

Obviously, the contract provision that I quoted earlier, paragraph (d)(2) says what it says. And the fact that it provides for repayment is an element of my reasoning as it was in numerous other cases that I cited and quoted from. However, I do not believe that Axis has set forth the basis under the declaratory judgment act for a ruling on its motion given that I believe there is no judicable controversy before me, no insurer has refused to return any funds obviously because there's yet to be any determination that such payments were not covered or such losses were not covered under the policy.

To my knowledge, no insurer has disclaimed that that would be the appropriate result if such a determination eventually is made and Axis has not pointed me to any such

disclaimer or other basis to sustain an argument that notwithstanding a right controversy it has legitimate concern that such contractual provision would be breached and, therefore, would be entitled to a determination now. So consequently, I will deny that motion without prejudice on the basis that, again, it does not set forth the basis on declaratory judgment act for relief given the absence of a case of controversy and a lack of any rightness.

There was no formal motion for an allocation of the priority of the payments to be made by Axis. I have, I believe, dealt with this issue before in my prior rulings in this matter. I do not believe that request is properly before me in the form of a motion or a properly raised controversy. It may ultimately be one, but in the first instance I believe that there has to be some dispute as to the allocation of priority and that in the absence of such dispute the terms of the contract will govern the party's conduct.

So the orders granting the summary judgment motions should provide that the Court has not determined any issue with respect to the priority of the advancement of defense costs and that all parties' rights and indeed all nonparties' rights in respect of priority allocations are fully preserved and reserved.

As I normally do when I give a lengthy bench ruling, particularly when I quote cases, I'll go over the transcript of

my ruling and reserve the right to amend it, both to correct it and to add something if I believe it was -- it should properly added, but my ruling won't change, which is that the summary judgment motions are granted.

So I would ask each of the -- well, not each of you, but the respective counsel for the groups of movants and Mr. Murphy to submit orders for their respective clients consistent with my ruling.

MS. KIM: Your Honor, we believe our proposed order is ready.

THE COURT: I don't think I have it on a disk, though.

MS. KIM: I'll submit it, Your Honor.

THE COURT: Okay. You could email them to chambers.

MS. KIM: Yeah, it says -- already says exactly that same language.

THE COURT: And you should cc: -- you don't need to settle it on Axis, but you should cc: Ms. Gilbride when you send it to chambers.

MS. KIM: Oh, they are.

THE COURT: So that she can make sure it's consistent with my ruling.

MS. KIM: Your Honor, may I raise one housekeeping issue?

THE COURT: Yes.

MS. KIM: Mr. Klejna would like to make a motion for summary judgment on coverage. We believe we can do so without going into the issue of anyone's knowledge because as the Court -- as the Court previously recognized in retaining jurisdiction on the counterclaim plaintiffs' complaint, we can prevail as a matter of law, for example, on the knowledge exclusion by demonstrating that as a matter of law the exclusion is not a part of the policy, because it was improperly added after the fact. We believe we can show --

THE COURT: But don't they have all the warranty -- don't they have the warranty issues as well?

MS. KIM: Well, Your Honor, we can show that the warranty is not a part of the policy as a matter of law also. It's not a part of the allocation.

THE COURT: What I'm going to ask you to do is put this in a letter to me, cc'ing Ms. Gilbride. It's not something I can --

MS. KIM: Oh, I was just going to ask --

THE COURT: No, I'm not going to give you leave to go forward on the summary judgment motion on just what you've told me today. I think you have to look at all of the exclusions that Axis has raised and not just the knowledge exclusions and I'm sorry, all of the defenses that Axis has raised and --

MS. KIM: We understand, Your Honor.

THE COURT: -- convince me that there's a reasonable

basis to go ahead on summary judgment notwithstanding the substantial overlap.

MS. KIM: Yes, sir. I'll do so, Your Honor. We don't believe that all the insureds are necessarily in the same position.

THE COURT: No, you're just going to be speaking for your particular client.

MS. KIM: Understood. Will do. Thank you, Your Honor.

MR. JEROME: I assume, Your Honor, that she'll also cc: the other insureds if different than --

THE COURT: That's right.

MS. KIM: All parties here.

THE COURT: Okay. All right. Okay. Anything further?

ALL ATTORNEYS: Thank you, Your Honor.

(Proceedings concluded at 12:11 p.m.)

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I certify that the foregoing is a court transcript from an electronic sound recording of the proceedings in the above-entitled matter, except where, as indicated, the Court has modified the transcript.

Ruth Ann Hager

Dated: October 12, 2007